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Kurt R. Sjoberg  
Auditor General (acting)

September 3, 1991

C-145

Assemblyman Robert E. Campbell, Chairman  
Members, Joint Legislative  
Audit Committee  
State Capitol, Room 2163  
Sacramento, California 95814

Dear Mr. Chairman and Members:

Senator David Roberti, Chairman of the Senate Rules Committee, requested that the Auditor General review and analyze the process followed by the Governor's Office in appointing an enrolled actuary for the Public Employees' Retirement System (PERS). Chapter 83, Statutes of 1991, requires the Governor to appoint an actuary for the PERS to be confirmed by both the Senate and Assembly.

BACKGROUND

Chapter 83 requires the Governor's Office to contract with an individual or firm practicing as an enrolled consulting actuary for a fixed period not to exceed three years. Chapter 83 further stipulates that the confirmed actuary may not be awarded a successive contract. In addition, the Governor is not required to comply with provisions of the law related to competitive bidding for this contract.

The confirmed actuary, for purposes of carrying out duties delineated in the law, assumes the fiduciary obligations pertaining to actuarial determinations previously held by members of the PERS board. Furthermore, the actuary will assume responsibility for the actuarial functions that PERS staff performed for the system and its contracting agencies.

GOVERNOR'S SELECTION PROCESS

The Governor's Office selected three individuals to act as a selection committee to identify for appointment a qualified individual or firm practicing as an enrolled consulting actuary. The team consists of David M. Caffrey, Deputy Chief of Staff - Administration for the Governor's Office, Lillian Rowett, Chief Deputy Director, Department of Personnel Administration, and Janice Rogers Brown, the Governor's Legal Affairs Secretary. The selection committee solicited technical and staff support from PERS and the Department of Personnel Administration (DPA) to

assist in the preparation and evaluation of a Request for Proposal (RFP). Two individuals from DPA, Ann McWherter, Manager in the Program Development Section and Wendell M. Coon, Chief of the Policy Development Office, and Stephen Young, Lead Actuary from the PERS, assisted the selection committee as technical advisors.

On July 16, 1991, the Governor's Office issued the RFP, designed from RFPs previously issued by the PERS for contracted actuarial services. The RFP was sent to some 23 individuals and firms whose names were provided by PERS. In addition, the RFP was requested by one other interested party. The RFP was not advertised. On July 26, 1991, the selection committee conducted a bidders' conference which was attended by 13 potential bidders. Following the bidders' conference on August 2, 1991, DPA issued a written summary of questions and answers from the conference. By 5:00 p.m. on the due date of August 7, 1991, the Governor's Office received proposals from 7 actuarial firms.

The RFP stipulated the scoring for the proposals. Each proposal was scored on technical merit and cost bid. Technical aspects of the proposal were allocated up to 76 percent of the points available. The two cost components, total amount bid and average cost per hour, were calculated based upon the relationship of the bid amounts to the lowest cost bid and were worth up to 24 percent of the total points. Once technical and cost scores were determined, proposers were selected for oral interviews. Oral interview scores were combined with technical cost scores for a final score and ranking. Oral interviews were worth 25 percent of the final score and technical and cost components comprised 75 percent of the final score.

The three technical advisors individually evaluated and scored the RFPs. Once the technical advisors completed their evaluations, they met as a committee and summarized the scores for each proposal, and recommended the three proposers with the highest scores for oral interviews. The selection committee met with the technical advisors and discussed each proposal and the advisors' summary scores. The selection committee agreed with the advisors results and recommendations, and chose the same three proposers for oral interviews. During the oral interviews, the proposer was to demonstrate the firm's ability to fully perform the provisions of the RFP.

The selection committee requested that the individual designated as the lead for the contract present the proposer's briefing. Each of the three proposers were allotted 20 minutes to present the firm's capabilities, experience, and commitment level to the selection

committee and the technical advisors. Robert D. Walton, Assistant Executive Officer at PERS, also participated in the oral interview process. During the remaining 40 minutes of the interview, the selection committee asked some set questions and some contemporaneous questions which related to the firm's proposal.

After the interviews, the selection committee members and advisors discussed the interviews. The following day, August 20, 1991, the selection committee as a group scored the oral interviews. The selection committee combined the oral interview scores with the summary evaluation scores and ranked the three firms in order of points.

The selection committee recommended TPF&C, a Towers Perrin Company (TPF&C) to the Governor for appointment as the PERS actuary. The Governor appointed TPF&C as the PERS actuary and is awaiting confirmation by the Senate and Assembly.

#### SCOPE OF THE AUDITOR GENERAL'S REVIEW

The Auditor General's objective in this review was to determine whether the Governor's Office followed provisions of the RFP and acceptable procurement procedures during its evaluation and selection process for the PERS actuary. We did not determine the qualifications or suitability of the any of the firms submitting proposals nor did we evaluate the actuarial services to be provided under the contract.

To conduct our review, we interviewed members of the selection committee and the technical advisors, analyzed the steps followed during the selection and proposal process, reviewed the provisions of Chapter 83, reviewed the RFP and the related seven proposals, and examined and recomputed the available scoring and rating documents.

#### ANALYSIS

Our review indicates that the Governor's selection committee followed the processes and procedures for choosing the enrolled actuarial firm for the PERS appointment outlined earlier in this letter. While the Governor's Office was specifically not required to follow provisions of law related to competitive bidding, the contract process followed many of the competitive bidding requirements. The selection processes and procedures appeared acceptable to reasonably ensure an impartial appointment of the PERS actuary.

The provisions of the RFP were based upon those generally included in PERS proposals to attain the services of actuaries. PERS assisted in the drafting of the RFP, particularly in the technical specifications areas. However, the RFP did not include several of the contract

provisions usually required for this type of procurement, such as Women/Minority/Disabled Veteran participation provisions, but Chapter 83 specifically exempted this contract from these requirements. In addition, although the Governor's Office did not advertise the RFP, it used a PERS listing to distribute the document to some 23 potential proposers. Even though the response time to the RFP was very short, about three weeks, the Governor's Office received seven proposals to the RFP.

The RFP stipulated a one-step technical and cost evaluation process: the technical and cost provisions are considered for all proposals rather than a two-step process which requires that a proposal meet a specific technical score before it is considered in the cost evaluation process. The technical advisors scored the technical portions of three of the seven proposals significantly higher than the other four. Specifically, three proposals received technical scores averaging 67.6 points out of a total of 76 points possible, where the remaining four proposals averaged 48.2 points for technical merit; nearly 20 points lower. Two technically lower-scoring proposals bid the lowest costs which affected the overall scoring of the proposals. As a result, the three technically superior proposals, which bid higher costs, received relatively few points for the two cost aspects of the scoring. This effectively eliminated cost as a factor in the final proposers' bid scores.

To determine whether the one-step evaluation process had a negative affect on the outcome of the proposal evaluation, we utilized the scoring methods we frequently use on Auditor General RFPs which advances only technically competitive proposals into the cost portion of the scoring process. We found that the results using our scoring methods mirrored the results of the Governor's Office evaluation process.

In addition, we recalculated or confirmed the scoring sheets, the score summary sheets, and the final score sheets (which included the oral interview scores) for each of the three technical advisors and found a few minor mathematical errors that did not effect the results of the evaluation process.

The RFP did not allow for a protest period. According to the selection committee and the technical advisors, several losing proposers contacted the committee to ascertain their own scores and to determine how they could be more competitive in the future. We did not attempt to contact the proposers to determine their opinion of the procurement process.

According to the selection committee, the contract has not yet been finalized. The committee indicated that, in addition to the confirmation process, several issues need to be resolved prior to executing a contract. We will address several issues in the recommendation section which follows that the Governor's Office should include in the final contract in the event of confirmation.

#### RECOMMENDATIONS

During our review of the successful proposal, we identified four issues that we believe should be addressed and resolved prior to executing a final contract. First, the TPF&C proposal indicates that the firm plans to establish an office in Sacramento "to expedite the work process ... and will provide an educational program to bring greater knowledge of the actuarial process to the State's decision makers." The RFP does not require a Sacramento office. TPF&C's proposal indicates that the cost of establishing and maintaining a Sacramento office is included in its rates and that the costs will be amortized over the life of the contract. However, TPF&C stipulates that in the event of an early termination of the contract, it reserves the right to recover the costs attendant to premature closure, the relocation of its Sacramento staff, and the unamortized costs not already recovered from establishing the office.

The costs associated with the start-up and closure of an office could be considerable. Therefore, the State needs to determine whether these costs are appropriately borne by the State; ensure that contract language is specific as to allowable costs; and specify the rate of amortization, if any, to be used in the event of a premature contract termination.

The second issue relates to the qualifying language included in TPF&C's proposal for liquidated damages. The RFP stipulates that "the due dates for deliverables are part of the agreement and that time is of the essence hereof. Accordingly, it is further agreed that there shall be deducted from the fee \$10,000 per day for each day that the certifications and recommendations due from the contractor are late." TPF&C's proposal states that "TPF&C's ability to produce deliverables in accordance with the required due dates depends upon factors outside our control. In particular, we will be entirely dependent upon PERS staff to be fully cooperative ... To the extent that delay in the production of deliverables is outside of TPF&C's control, we cannot be held responsible for the \$10,000 daily liquidated damages."

In negotiating the final contract terms, the State should ensure that the contract provisions minimize the possibility of the contractor shifting away their contracted liability for deliverables. The Governor's Office should ensure that PERS is fully cooperative with the contractor in providing the data and support necessary for the contractor to meet the contracted due dates. Open lines of communication between the contractor, the Governor's Office and the PERS are essential to ensure that all parties are aware of perceived or actual difficulties in meeting contracted due dates.

The third contract issue is that of the right of ownership of any computer software developed under this contract. While TPF&C's proposal indicates that it will utilize existing software to conduct the tasks detailed in the RFP, circumstances may arise where it will be necessary to develop new software to meet the terms of a Task III proposal or other tasks of the contract. Therefore, the State needs to specifically address the conditions and ownership of any software product developed under the provisions of this contract.

Finally, similar to other contracts, the State should include a provision specifying that the contract is subject to the examination and audit by the Auditor General or other auditors designated by the Governor's Office for a period of three years after final payment under the agreement.

#### OTHER ISSUES

Senate Rules Committee requested that we provide information indicating the consequences which might result from postponing a decision on the confirmation of the actuary until January 1992. The RFP indicates that the first task under the contract is due and deliverable by November 20, 1991. In addition, Task II delineates several studies and reports which are due beginning in March 1992. Further, Chapter 83 removes the authority of PERS to perform the actuary work that is transferred to the contractor.

We discussed this issue with members of the selection committee and the advisors, and persons at PERS to determine their views of the consequences of not confirming an actuary until January. The consensus of the individuals that we spoke with is that the work due by November 20, 1991, would not be completed and Task II would be significantly delayed if confirmation does not take place until January 1992. Further, it appears that although PERS has the staff and the expertise to perform the task, without some enabling legislation, it lacks the authority to do so.

Chairman and Members  
Joint Legislative Audit Committee  
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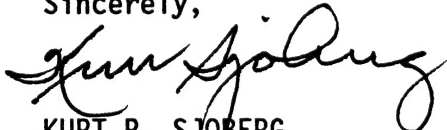
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Task I requires the contractor to determine the state employer contribution rates for fiscal year 1992/93 and deliver a report by November 20, 1991. The new employer contribution rates contained in this report will also be used in the Governor's Budget. It is likely, therefore, that the earliest the valuation could be delivered would be two to three months after the actuary's confirmation. Further, this would probably significantly delay the Task II projects slated for completion after Task I.

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Due to the short nature of this assignment, we did not conduct our review in accordance with Generally Accepted Government Auditing Standards. We believe, however, that this letter fulfills the scope of the Senate Rules Committee's request.

Sincerely,

A handwritten signature in cursive script, appearing to read "Kurt Sjoberg".

KURT R. SJOBERG  
Auditor General (acting)